

## CLIENT MEMORANDUM

# Update on the FDIC's Advisory Statement Regarding the Scope and Significance of Exclusions in D&O Insurance Policies

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## AUTHORS

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On October 10, 2013, the Federal Deposit Insurance Corporation (the "FDIC") issued an advisory statement expressing its concern about an increase in exclusionary terms contained in directors and officers liability insurance policies issued to depository institutions. In particular, the statement reminded directors and officers of banks that a bank's purchase of insurance indemnifying against civil money penalties ("CMPs") is prohibited. However, the advisory statement left open questions regarding (1) whether banks that are primarily regulated by the Office of the Comptroller of the Currency, the Federal Reserve, or state regulatory agencies should be mindful of the FDIC's admonition regarding the prohibition on insurance coverage for CMPs; and (2) whether FDIC-regulated banks can still seek insurance for defense costs related to regulatory investigations.

A CMP may be assessed for the violation of any law or regulation, as well as for a violation of any condition imposed in writing by a banking agency in connection with any written agreement between a bank and the federal agency. In its statement, the FDIC reminds directors that FDIC regulations prohibit banks from purchasing insurance that could be used to pay or reimburse an institution-affiliated party (an "IAP") for the cost of any CMP assessed against such person in an administrative proceeding or a civil action commenced by any federal banking agency. The statement also makes clear that the FDIC regulations do not include an exception for cases in which an IAP reimburses the depository institution for the designated cost of the CMP coverage. The "FDIC regulations" referenced are Section 1828(k)(6) of Title 12 of the

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United States Code and Section 359.1(l)(2)(i) of Title 12 of the Code of Federal Regulations. These regulations apply to all insured depository institutions, and their subsidiaries and affiliated depository institution holding companies, regardless of asset size, including all national banks, community banks, and state-chartered banks and their corresponding directors and officers. Thus, the FDIC's guidance regarding the prohibition of coverage for CMPs should apply to these institutions even if the FDIC is not their primary regulator.

With respect to defense costs, the FDIC regulations do not prohibit an insurance policy that had been paid for by an insured depository institution from providing coverage for "any legal or professional expenses incurred in connection with such proceeding . . ." 12 CFR § 359.2(l)(2)(i). In addition, if there has been a formal and final adjudication or finding that a director or officer has not violated banking laws and regulations or has not engaged in unsafe and unsound banking practices or violations of fiduciary duties, the insured depository institution itself may indemnify the individual for legal or professional expenses. See 12 CFR 359.2(l)(2)(ii).

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